CHEMICALBANKING Corporation

MANUFACTURERS HANOVER

Financial Digest

Volume XXIX, Number 8 Monday, April 20, 1992

Analysis of Business Trends Plus Selected Financial Indicators

Nikkei Meltdown

One of the more persistent worries plaguing the global financial community in recent years has been the potentially negative impact of an equity price meltdown in Tokyo. Driven to ever-loftier heights in the late 1980s on the back of a relaxed monetary policy and a liquidity river generated by record trade and current account surpluses, Japanese stock prices defied the laws of gravity, and were widely believed to be headed for a tumble. This time the bears got it right, and, since peaking at the end of 1989, the widely-watched Nikkei Index of 225 stocks has shed more than 55 percent of its value. But where the more pessimistic pundits got it wrong was in their prognosis of the likely fallout elsewhere. The ripples emanating from Japan's protracted stock slide have been far from apocalyptic; stock markets virtually everywhere else have marched to the tune of a different drummer—especially in the United States, where the Dow Jones Industrial Average vaulted to an all-time high last week.

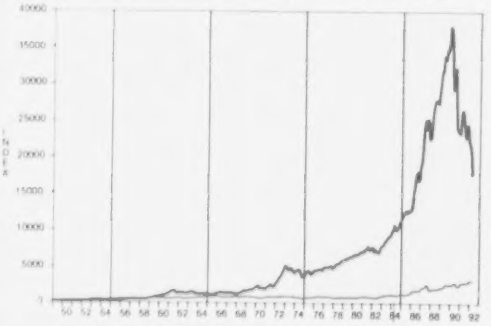
Above all, this reflects the realization that Tokyo's ills stem from the particular problems confronting Japan's economy and financial system, rather than any systemic deficiencies of the global financial network. It also underscores the fact that neither the Japanese government nor institutional investors have pushed the panic button. There is little indication that significant official action will be initiated to prop up the faltering equity market and there are few concrete signs that institutional investors are liquidating their overseas investment portfolios to compensate for losses at home. Indeed, Japanese institutions continue to cautiously add to such investments in the markets they deem ripe for appreciation.

The ongoing deflation of Japan's stock price "bubble" cannot be divorced from the pronounced slowdown of Japan's economy. For in contrast with the United States—where a spate of firmer economic statistics suggests that the economy is picking up (Financial Digest—March 28, 1992)—the Japanese economy has not only cooled decidedly, but by some yardsticks, is experiencing its deepest slump since the first oil "shock" of the early 1970s. Paced by a slide in domestic spending, inflation-adjusted gross national product actually posted a rare contraction in the fourth quarter of last year.

Pluses and Minuses

As in most other industrial countries, Japanese consumers have turned cautious. Retail sales are posting only marginal gains, housing starts have zig-zagged lower over the past year and automobile sales, especially of imported models, have flattened. Nor does the manufacturing sector look any healthier. Inventories continue to pile up from already bloated levels, machinery and construction orders are contracting, and manufacturers are scrambling to trim output. Not surprisingly, an ever-expanding number of firms are planning capital spending cutbacks; many have to, especially when you consider the toll of all this on corporate earnings. By some estimates, company earnings may fall by as much as 15 percent in the current fiscal year, and if they do, it would mark the third consecutive annual drop.

DOW JONES INDUSTRIAL AVERAGE (THIN) VS. NIKKEI STOCK AVERAGE (THICK) (MONTHLY AVERAGES)



A contracting economy and plunging profitability are hardly the ingredients for rising equity prices—even now, with the much deflated Nikkei Index still trading at a price-earnings multiple in the neighborhood of 35, not to mention the 70 times earnings during the halcyon days of the late 1980s (see chart). Yet, while equity prices are being painfully wrenched back to reality, today's bearishness toward Japan should not be exaggerated. For one thing, although consumer spending has softened, households are far less pressed in Japan than in such countries as the United States and the United Kingdom—employment is at a record high, a comfortable savings buffer exists and incomes are firm. For another, inflation has slowed, and the current trend in wage settlements should prompt further improvement. Finally, global competitiveness remains keen, perhaps too

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much so since Japan's trade and current account surpluses have vaulted over the $10 billion per month level.

High Profile Concerns

Nonetheless, good news about Japan doesn't sell these days, and until the equity price plunge abates, two high-profile and closely intertwined concerns will persist. First, how much trouble does this spell for the Japanese banks, which in recent years have been the liquidity spigot for the global financial system, and, second, will these banks, and other institutional lenders be forced to liquidate large chunks of their vast overseas investment portfolios? For the banks, the news is troubling. Since they are permitted to own up to five percent of the shares of industrial companies, and count toward their capital bases up to 45 percent of unrealized equity price gains, the accelerating stock price plunge has eroded the capital cushion protecting them against loan losses. By itself, this is bad enough.

But equally disturbing is the timing. For the banks now find themselves caught between a rock and a hard place: The rock is the need to comply with the stricter bank capital standards in general adopted by the Bank for International Settlements in 1988—and taking effect in

Short Term Paper Outstanding

(Millions of Dollars)

Time Deposits $100,000 or more Weekly Reporting Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/1/92)	151,272	- 1,036	- 49,485
New York City (4/1/92)	25,669	- 12	- 6,490
Commercial Paper (4/1/92)	535,880	- 5,263	- 24,067

Bank Loans

(Millions of Dollars)

Commercial and Industrial Loans

Weekly Reporting Large Commercial Banks	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/1/92)	290,068	+ 905	- 30,685
New York City (4/1/92)	49,860	- 115	- 7,649

Total Loans and Leases Gross Adjusted

	Latest Week	Change Since Week Ago	Change Since Year Ago
Nationwide (4/1/92)	1,018,132	+ 2,962	- 29,680
New York City (4/1/92)	168,255	+ 4,784	- 5,914

Financial Markets

	Thursday 4/16/92	Change Since Week Ago	Change Since Year Ago
U.S. Governments, Closing Yields:			
90-Day Bills†	3.74%	+ .01	- 2.17
180-Day Bills†	3.90	+ .04	- 2.10
Longest Bills†	4.20	+ .10	- 2.07
Recent Issues:			
5¼s 3/31/94	5.28	+ .15	
6⅞s 3/31/97	6.75	+ .14	
7⅛s 11/15/01	7.44	+ .09	
8s 11/15/21	7.93	+ .04	
Municipals:			
Bond Buyer—20 Bond Index* (4/15/92)	6.60%	- .06	- .38
Blue List Total ($ Million)	$ 921	- $ 32	- $ 294
30-Day Visible Supply ($ Million)	$4,713	+ $880	+$2,114
Total	$5,634	+ $848	+$1,820
Corporates:			
Moody's Aa Composite (4/15/92)	8.68%	+ .02	- .42
30-Day Visible Supply ($ Million)	$ 760	+ $200	+$ 500
Stocks:			
Dow-Jones Averages:			
Industrials	3,366.50	+ 141.54	+400.91
Transportation	1,396.86	+ 58.30	+225.31
Utilities	210.13	+ 7.01	- 2.71
65 Stocks	1,195.42	+ 48.52	+136.84
N.Y.S.E. Composite Index	228.90	+ 7.80	+ 18.67
N.Y.S.E. Avg. Daily Vol. for Week (000's)	220,655	- 10,259	+12,973

*34% Taxable equivalent 10.00% † Bond equivalent

International Rates

EURODOLLAR DEPOSIT RATES (bid)	Thursday 4/16/92	Week Ago
Overnight	3.94%	3.69%
1 month	4.13	3.88
3 month	4.13	4.00
6 month	4.31	4.06
1 year	4.63	4.44

FOREIGN EXCHANGE SPOT RATES

New York Opening (4/16/92)	Currency Per U.S. $	Week Ago
Belgium	34.12	33.41
Canada	1.1804	1.1884
France	5.6106	5.4915
Germany	1.6595	1.6248
Italy	1247.53	1223.53
Japan	133.35	132.40
Mexico	3062.51	3059.00
Netherlands	1.8670	1.8285
South Korea	780.25	792.39
Switzerland	1.5325	1.4915
Taiwan	25.00	24.91
U.K.*	1.7578	1.7718

*U.S. $ per U.K. pound

CHEM TRADE-WEIGHTED DOLLAR (4/16/92) (Adjusted for Inflation)	Change Since Week Ago	Change Since 2/27/85
	+0.6%	-20.3%

April 1993—and the hard place is their souring portfolio of global real estate loans against which their capital buffers in particular need to be enhanced. With the equity market in retreat, Japanese banks may have to either load up on subordinated debt or shrink their asset bases. Regardless of the route taken, this raises the bug-a-boo of a global credit "crunch"; fortunately, it occurs at a time when industrial country credit demands are fading in line with the slowing of economic activity.

Perhaps because of this, there is little urgency to lighten carefully-crafted overseas investment portfolios in order to take advantage of much diminished lending opportunities. According to the Securities Dealers Association of Japan, such portfolios actually continue to expand, rather than contract. Net foreign currency bond purchases by Japanese institutions rose by nearly $56 billion last year, 39 percent above 1990 levels; they added another $3½ billion in January of this year. And, why shouldn't they? With Japanese bond yields the lowest among the Group of Seven industrial countries, and Japan again awash in trade-generated liquidity, Japanese institutions will remain strongly attracted to high-yield bonds abroad, notwithstanding—or perhaps even because of—deepening difficulties at home.

Selected Federal Reserve Data

(Averages of Daily Figures—Billions of Dollars)

	Week Ending 4/8/92	$ Change Since Week Ago	$ Change Since Year Ago
Reserve Bank Credit			
U.S. Gov'ts and Agencies Owned Outright & RPs	273.471	- 1.918	+24.600
Loans to Depository Inst.	.048	- .119	- .126
Float	.497	+ .159	- .391
Total Reserve Bank Credit	304.484	- 4.243	+17.968
Treasury Deposits with Federal Reserve Banks	5.438	+ .253	+ .643
Currency in Circulation	304.458	+ 1.486	+16.261
Gov'ts held for Foreign Acct. by F.R. Banks (End-of-Week)	271.960	+ .377	+32.444
	4/1/92		
Member Bank Reserves:			
Total Reserves Held	56.294	- .108	+ 7.357
Excess (Deficiency)	1.626	+ 1.126	+ .252
Net Free Reserves	1.510	+ 1.083	+ .286

Monetary Aggregates †		‡ % Change Since 3 Months Ago*	‡ % Change Since Year Ago
M1 (3/30/92)	935.5	+ 18.2	+ 11.5
M2 (3/30/92)	3.461.4	+ 3.5	+ 2.5
M3 (3/30/92)	4.172.6	+ 1.4	+ 0.5
Domestic Nonfinancial Debt (4th Q'91)	11.229.1	+ 5.3	+ 4.4

† Seasonally adjusted.

* Seasonally adjusted annual rate.
‡ Four-week moving average.

New York Money Market

Offering Rates 4/16/92	3 Months	6 Months	1 Year
‡ U.S. Treasury Bills	3.64%	3.75%	4.02%
* Federal Agencies	3.50	3.90	4.25
* Municipal Notes–High Grade (34% Taxable Equivalent)	4.92	4.39	4.70
Negotiable Time CDs			
Chemical	Rates By Arrangement		
* Secondary Market–Prime	4.00	4.12	4.50

‡ Finance Company Paper–Prime		‡* Bankers' Acceptances	
5- 14 days	3.80%	May	3.82%
15- 29 days	3.85	Jun.	3.81
30- 59 days	3.88	Jul.	3.80
60- 89 days	3.88	Aug.	3.83
90-179 days	3.90	Sep.	3.85
180-239 days	3.90	Oct.	3.85
240-270 days	3.90		
‡ Industrial Paper–Prime			
30- 89 days	3.96%	†Federal Funds Effective Rate	3.88%
90-120 days	3.97		

‡ Discount basis. *Subject to availability. † Estimated.

Selected Business Indicators

(All Dollar Figures in Billions)

		Latest Period or End of Period	Previous Period	Year Ago Period
Gross Domestic Product (Current Dollars)*	4th Q'91	$ 5,740	$ 5,709	$ 5,558
Gross Domestic Product (1987 Dollars)*	4th Q'91	$ 4,868	$ 4,863	$ 4,855
Percent Change, Annual Rate	4th Q'91	0.4	1.8	- 3.9
Change in Consumer Prices*	Mar '92 p	6.0%	3.6%	1.2%
Change in CHEM Cost of Living Index*	Mar '92 p	6.0%	7.2%	4.8%
Change in Producer Prices*	Mar '92 p	2.4%	2.4%	- 3.6%
Civilian Employment (Thousands of Persons) †	Mar '92	117,348	117,043	116,834
Unemployment as % of Civilian Labor Force †	Mar '92	7.3%	7.3%	6.7%
Personal Income*	Feb '92	$ 4,972	$ 4,918	$ 4,761
Leading Indicators Composite Index (1967=100) †	Feb '92	147.6	146.5	140.4
Industrial Production Index (1977=100) †	Mar '92 p	107.2	106.9r	105.0
Net Change in Consumer Installment Credit †	Feb '92 p	$ 0.20	- $ 0.05r	- $ 0.20
U.S. Merchandise Trade Balance †	Feb '92 p	$ 3.38	- $ 5.95r	- $ 5.50
Plant and Equipment Expenditures*	2nd Q '92 p	$ 557.5(a)	$ 545.0(a)	$ 524.6
Private Housing Starts (Thousands of Units)*	Feb '92	1,364	1,190	1,008
New Construction Expenditures*	Feb '92	$ 400.2	$ 407.9	$ 410.1
Total Business Inventories †	Feb '92 p	$ 813.0	$ 813.0r	$ 827.6r
Total Business Sales †	Feb '92 p	$ 544.8	$ 537.2r	$ 527.8r

*Seasonally adjusted annual rate. † Seasonally adjusted. p-Newly reported figure. r-Revised. a-Anticipated.

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